

FAYETTE REGIONAL HEALTH SYSTEM

TABLE OF CONTENTS SEPTEMBER 30, 2007 AND 2006

	Page
Report of Independent Auditors	1
Financial Statements	
Statements of Financial Position	2
Statements of Operations	4
Statements of Changes in Net Assets	5
Statements of Cash Flows	6
Notes to Financial Statements	7

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Fayette Regional Health System
Connersville, Indiana

We have audited the accompanying statements of financial position of Fayette Regional Health System (the System) as of September 30, 2007 and 2006, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of September 30, 2007 and 2006 and the results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Blue & Co., LLC

January 17, 2008

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF FINANCIAL POSITION SEPTEMBER 30, 2007 AND 2006

ASSETS		<u>2007</u>	<u>2006</u>
Current assets			
Cash and cash equivalents	\$	864,958	\$ 1,850,093
Accounts receivable			
Patient services, net		11,598,206	11,247,147
Other		694,159	420,894
Inventories		1,096,100	1,130,502
Prepaid expenses and other current assets		508,245	641,816
Estimated third-party settlements		1,919,113	-0-
Total current assets		<u>16,680,781</u>	<u>15,290,452</u>
Investments		15,251,483	14,214,241
Assets limited as to use			
Restricted cash		-0-	2,450
Total assets limited as to use		<u>-0-</u>	<u>2,450</u>
Property and equipment			
Land		1,344,783	1,410,452
Land improvements		786,140	688,951
Buildings and building equipment		47,639,869	45,551,412
Major movable equipment		25,424,568	24,306,841
Construction in progress		110,658	649,207
Total property and equipment		<u>75,306,018</u>	<u>72,606,863</u>
Less accumulated depreciation and amortization		<u>(42,604,481)</u>	<u>(39,500,293)</u>
Net property and equipment		32,701,537	33,106,570
Interest in net assets of Foundation		2,530,516	2,704,554
Property held for sale, net		426,062	-0-
Other assets		766,236	802,550
Total assets		<u><u>\$ 68,356,615</u></u>	<u><u>\$ 66,120,817</u></u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF FINANCIAL POSITION SEPTEMBER 30, 2007 AND 2006

LIABILITIES AND NET ASSETS

	2007	2006
Current liabilities		
Current maturities of long-term debt	\$ 798,692	\$ 765,566
Current maturities of capital leases	129,115	130,917
Accounts payable	1,120,074	854,694
Accrued salaries, wages, and payroll taxes	2,187,401	1,545,340
Other accrued liabilities	420,193	729,199
Estimated third-party settlements	-0-	176,205
Total current liabilities	4,655,475	4,201,921
Derivative liability	366,746	475,254
Long-term debt, less current maturities	23,582,149	24,380,725
Long-term capital leases, less current maturities	274,760	414,701
Total liabilities	28,879,130	29,472,601
Net assets		
Unrestricted	36,946,969	33,941,212
Temporarily restricted	-0-	2,450
Temporarily restricted - interest in Foundation's net assets	2,530,516	2,704,554
Total net assets	39,477,485	36,648,216
Total liabilities and net assets	<u>\$ 68,356,615</u>	<u>\$ 66,120,817</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF OPERATIONS YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
Net revenues		
Net patient service revenue	\$ 55,316,885	\$ 53,246,146
Other revenue, net	2,976,044	2,297,288
Net assets released from restrictions	2,450	-0-
Total revenue	58,295,379	55,543,434
Expenses		
Salaries, wages and fringe benefits	31,566,576	32,176,883
Supplies and drugs	5,904,620	5,915,300
Purchased services	6,289,892	5,638,633
Utilities	1,393,946	1,534,651
Bad debts	4,511,338	3,847,350
Depreciation and amortization	3,630,566	3,606,735
Interest	1,195,103	1,221,086
Other operating expenses	1,950,080	2,050,547
Total expenses	56,442,121	55,991,185
Excess of revenue over expenses	1,853,258	(447,751)
Other changes in unrestricted net assets		
Contributions	319,050	7,861
Net unrealized gain on investments	724,941	549,582
Unrealized gain on derivatives	108,508	589,013
Change in unrestricted net assets	<u>\$ 3,005,757</u>	<u>\$ 698,705</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF CHANGES IN NET ASSETS YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
Unrestricted net assets		
Excess of revenue over expenses	\$ 1,853,258	\$ (447,751)
Contributions	319,050	7,861
Net unrealized gain on investments	724,941	549,582
Unrealized gain on derivatives	108,508	589,013
Change in unrestricted net assets	3,005,757	698,705
Temporarily restricted net assets		
Restricted contributions	-0-	2,450
Net assets released from restrictions	(2,450)	-0-
Change in interest in net assets of Foundation	(174,038)	175,503
Change in temporarily restricted net assets	(176,488)	177,953
Change in net assets	2,829,269	876,658
Net assets, beginning of year	36,648,216	35,771,558
Net assets, end of year	<u>\$ 39,477,485</u>	<u>\$ 36,648,216</u>

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

STATEMENTS OF CASH FLOWS YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
Operating activities		
Change in net assets	\$ 2,829,269	\$ 876,658
Adjustments to reconcile change in net assets to net cash from operating activities		
Change in interest in net assets of the Foundation	174,038	(175,503)
Unrealized gain on derivatives	(108,508)	(589,013)
Depreciation and amortization	3,630,566	3,606,735
Bad debts	4,511,338	3,847,350
Net realized and unrealized gain on investments	(1,736,635)	(900,379)
(Gain) loss on disposal of property and equipment	7,258	12,233
Contributions of property and equipment	(319,050)	-0-
Changes in current assets and liabilities:		
Accounts receivable	(5,135,662)	(4,879,173)
Inventories, prepaid expenses and other current	167,973	(66,185)
Accounts payable and accrued liabilities	598,435	47,164
Estimated third-party settlements	(2,095,318)	1,930,900
Net cash from operating activities	2,523,704	3,710,787
Investing activities		
Purchases of property and equipment	(3,300,404)	(2,915,996)
Proceeds from sale of property and equipment	-0-	9,915
Change in assets limited as to use, net	2,450	(2,450)
Other changes in investments, net	699,393	(45,327)
Change in other assets, net	(2,970)	(3,959)
Net cash from investing activities	(2,601,531)	(2,957,817)
Financing activities		
Payments on long-term debt	(765,565)	(739,575)
Payments on capital leases	(141,743)	(98,455)
Net cash from financing activities	(907,308)	(838,030)
Net change in cash and cash equivalents	(985,135)	(85,060)
Cash and cash equivalents, beginning of year	1,850,093	1,935,153
Cash and cash equivalents, end of year	\$ 864,958	\$ 1,850,093
Supplemental disclosures of cash flow information		
Cash paid for interest net of amount capitalized	\$ 1,195,103	\$ 1,221,086
Non-cash investing and financing activities		
Property additions through capital lease obligations	\$ -0-	\$ 349,979

See accompanying notes to financial statements.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

Organization

Fayette Memorial Hospital Association, Inc. dba Fayette Regional Health System (the System) is located in Connersville, Indiana, and includes a not-for-profit acute care hospital. The System provides inpatient, outpatient, emergency and other ancillary services for residents of east central Indiana.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits and investments in highly liquid debt instruments with maturities of three months or less from the date of purchase. The System maintains its cash in bank deposit accounts which, at times, may exceed the federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on cash and cash equivalents.

Allowance for Patient Services Accounts Receivable

The System evaluates the collectibility of its accounts receivable based on certain factors, such as payer type, historical collection trends and aging categories. The allowance that is applied to the receivable balances is based on the historical experience and time limits, if any, for each particular payer source, such as private, insurance, Medicare and Medicaid. Actual results could differ from the estimated allowances.

Investments

Investments consist primarily of U.S. government securities, corporate bonds and various equity securities. Investments are carried at fair value. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses as the investments are not considered trading securities.

Inventories

Inventories are determined by physical count and valued at the lower of cost (first-in, first-out method) or market value.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

Temporarily Restricted Net Assets

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received and are included in other revenue if the promise to give is unrestricted. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. At September 30, 2007 and 2006, temporarily restricted net assets were restricted for the purpose of purchasing capital assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Assets Limited as to Use

Assets limited as to use include assets restricted by donor. These assets consist primarily of cash.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Useful lives are 3 to 40 years for property and equipment.

Gifts of long-lived assets such as land, buildings or equipment are reported as unrestricted support and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the donated assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

Property Held for Sale

The System has closed one of its off-site locations and has put the property up for sale. The net amount of \$426,062 has been shown as a separate item on the statement of financial position. The property held for sale consists of the following as of September 30, 2007:

Land	\$ 65,669
Building	<u>600,274</u>
	665,943
Accumulated depreciation	<u>(239,881)</u>
	<u>\$ 426,062</u>

Excess of Revenue Over Expenses

The statements of operations include excess of revenue over expenses. Changes in unrestricted net assets which are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets) and unrealized gains on derivatives.

Other Assets

Deferred financing costs are recorded at cost. Amortization is computed using the effective interest method over the life of the bonds. Amortization expense for 2007 and 2006 is \$39,284. Amortization expense for the next five years is \$39,284 per year.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity Care

The System provides charity care on a case-by-case basis for those patients who meet certain criteria of financial need. This care is provided without charge or at amounts less than established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

Pension Plans

The System maintains a defined contribution pension plan (the Plan) covering substantially all employees. The System contributes 2% of each employee's salary and matches 100% of employee deferral contributions up to 3% of the employees' salary, subject to certain eligibility requirements.

The System also maintains a 457(b) deferred compensation plan that provides for non-elective employer deferrals covering a select group of management or highly compensated individuals.

It is the System's policy to fund pension costs as accrued. Pension expense was \$1,008,624 and \$988,721 in 2007 and 2006, respectively.

Federal and State Income Taxes

The System is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code.

Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were \$390,353 and \$406,575 in 2007 and 2006, respectively.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Medical Malpractice Claims

The System participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries an occurrence basis insurance policy covering the System's \$250,000 of exposure per claim. Accordingly, the System has not recorded any provision for self-insured medical malpractice claims.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

Reclassification

Certain 2006 balances were reclassified to agree with the current year presentation.

2. NET PATIENT SERVICES ACCOUNTS RECEIVABLE

Net patient services accounts receivable consists of the following as of September 30, 2007 and 2006:

	2007	2006
Gross patient accounts receivable	\$ 19,774,897	\$ 18,746,233
Allowance for estimated contractual adjustments	(7,189,314)	(6,677,988)
Allowance for uncollectible accounts	(987,377)	(821,098)
Net patient services accounts receivable	<u>\$ 11,598,206</u>	<u>\$ 11,247,147</u>

3. INVESTMENTS

The composition of investments at September 30, 2007 and 2006 follows:

	2007	2006
Cash and cash equivalents	\$ -0-	\$ 2,450
Bond funds	1,103,137	994,231
Common stock	11,314,908	10,711,650
Corporate bonds and notes	190,051	207,725
Convertible securities	887,438	569,246
Preferred securities	171,436	254,215
U.S. Government and mortgage backed securities	<u>1,584,513</u>	<u>1,477,174</u>
	15,251,483	14,216,691
Less		
Investments	<u>15,251,483</u>	<u>14,214,241</u>
Assets limited as to use	<u>\$ -0-</u>	<u>\$ 2,450</u>

Investment return for the years ended September 30, 2007 and 2006 is as follows:

	2007	2006
Investment income		
Interest and dividend income	\$ 455,330	\$ 416,643
Realized gains, net	<u>1,011,694</u>	<u>350,797</u>
	1,467,024	767,440
Net unrealized gain on investments	<u>724,941</u>	<u>549,582</u>
Investment return, net	<u>\$ 2,191,965</u>	<u>\$ 1,317,022</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

4. INTEREST IN NET ASSETS OF THE FOUNDATION

The Fayette Memorial Hospital Foundation, Inc., dba Fayette Regional Health System Foundation (the Foundation), which is a financially interrelated organization with Fayette Regional Health System was established to solicit contributions from the general public and to support the System activities. Funds are distributed to the System as determined by the Foundation's Board of Trustees. A summary of the Foundation assets, liabilities, net assets, results of operations and changes in net assets for September 30, 2007 and 2006, follows. The System's interest in the net assets of the Foundation is reported as a non-current asset in the balance sheets.

	2007	2006
Financial position		
Assets, principally cash, investments and property	<u>\$ 2,563,205</u>	<u>\$ 2,716,584</u>
Liabilities	\$ 32,689	\$ 12,030
Net assets	<u>2,530,516</u>	<u>2,704,554</u>
Total liabilities and net assets	<u>\$ 2,563,205</u>	<u>\$ 2,716,584</u>
Statement of activities		
Support, revenue and income	574,872	\$ 141,954
Expenses		
Contributions to Fayette Regional Health System	319,050	8,159
Other	<u>302,666</u>	<u>215,376</u>
Total expenses	<u>621,716</u>	<u>223,535</u>
Excess revenue over (under) expenses	(46,844)	(81,581)
Net unrealized gains/(loss) on investments	60,994	61,132
Unrestricted net assets, beginning of year	<u>2,021,692</u>	<u>2,042,141</u>
Unrestricted net assets, end of year	<u>2,035,842</u>	<u>2,021,692</u>
Temporarily restricted net assets	<u>494,674</u>	<u>682,862</u>
Net assets, end of year	<u>\$ 2,530,516</u>	<u>\$ 2,704,554</u>
Change in temporarily restricted net assets	\$ (188,188)	\$ 195,952
Change in interest in Foundation	\$ (174,038)	\$ 175,503

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

The System provided accounting and financial management services to the Foundation of approximately \$180,000 during 2007 and 2006.

5. DERIVATIVE LIABILITY

During the year ended September 30, 2002, the System entered into two "cash flow hedge interest rate swap" agreements with a financial institution. The System pays a fixed interest rate and the financial institution pays a variable interest rate (4.10% and 3.90% at September 30, 2007 and 2006, respectively) over the term of the agreements.

The System's objective is to provide protection against market driven increases in variable interest rates. The fair value of each agreement was determined by the financial institution using the present value of the estimated projected cash flows. The System is in a liability position as of September 30, 2007 and 2006 due to the present value of its estimated projected cash flows being greater than the financial institution's present value of estimated projected cash flows.

The first swap was effective on February 28, 2002, was amended on September 1, 2005 and matures on October 1, 2032. It contains an outstanding notional amount of \$13,410,000 with a 3.47% fixed rate of interest and is a derivative asset for the System with a fair value as of September 30, 2007 and 2006 of \$109,129 and \$41,090, respectively.

The second swap was effective on July 3, 2002, was amended on September 1, 2005 and matures on October 1, 2022. It contains an outstanding notional amount of \$10,525,000 with a 4.13% fixed rate of interest and is a derivative liability for the System with a fair value as of September 30, 2007 and 2006 of \$475,875 and \$516,344, respectively.

The total derivative liability recognized on the financial statements as an unrealized loss on derivatives is \$366,746 and \$475,254 for 2007 and 2006, respectively. The liability is only payable upon termination of the agreements by the System.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

6. LONG-TERM DEBT AND LINE-OF-CREDIT

A summary of long-term debt at September 30, 2007 and 2006 follows:

	<u>2007</u>	<u>2006</u>
Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 1998, Adjustable interest rate every 5 years, 2.79% at September 30, 2007 with monthly principal amounts, due in 2018	\$ 445,841	\$ 481,291
Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2002A, variable interest rate, serial bonds, principal maturing in varying annual amounts, due in 2032	13,410,000	13,700,000
Indiana Health Facility Financing Authority Hospital Revenue Bonds, Series 2002B, Variable interest rate, serial bonds, principal maturing in varying annual amounts, due in 2022	<u>10,525,000</u>	<u>10,965,000</u>
	24,380,841	25,146,291
Less current maturities	<u>(798,692)</u>	<u>(765,566)</u>
Long-term debt, less current maturities	<u>\$ 23,582,149</u>	<u>\$ 24,380,725</u>

On February 1, 2002, the System issued \$13,980,000 of revenue bonds, Series 2002A through the Indiana Health Facility Financing Authority for the purchase of a computer system and the construction of an addition to the System facilities.

On July 1, 2002, the System issued \$12,185,000 of revenue bonds, Series 2002B through the Indiana Health Facility Financing Authority to refinance the Series 1992 bonds and a 1997 lease.

The System has entered into an interest rate swap agreement related to the 2002 Series A and B bonds (Note 5).

On May 18, 1999, the System issued \$1,400,000 of Revenue bonds, Series 1998 through the Indiana Health Facility Financing Authority for the purchase of computer equipment and the construction of a new facility.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

Principal repayments on long-term debt for the next five years are as follows:

Year ending September 30,	
2008	\$ 798,692
2009	837,342
2010	868,379
2011	909,482
2012	945,598
Thereafter	<u>20,021,348</u>
	<u>\$ 24,380,841</u>

The System has a letter-of-credit for the 2002A Bonds in the amount of \$13,567,644 that is due to expire February 28, 2010. The System has a letter-of-credit for the 2002B Bonds in the amount of \$10,646,109 that is due to expire July 3, 2008. The System has pledged certain assets and is subject to covenants related to the debt instruments. The System has received a waiver for one of the covenants and management believes they are in compliance with the remaining covenants.

As of September 30, 2007 and 2006, the System had no borrowings on its \$7,200,000 revolving line of credit, which bears interest at 1.25% above the LIBOR standard lending rate (6.57% at September 30, 2007). The line of credit is secured by the System's investments.

7. LEASE OBLIGATIONS

The System leases equipment under non-cancelable operating leases expiring in various years through 2010. Total rental expense amounted to \$881,567 and \$981,017 for 2007 and 2006, respectively. Future minimum payments under the operating leases with initial terms in excess of one year are as follows:

Year ending September 30,	
2008	\$ 520,088
2009	141,594
2010	<u>27,470</u>
	<u>\$ 689,152</u>

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

In October 2004, the System entered into a capital lease arrangement for an MRI upgrade. The lease agreement is non-cancelable for 5 years. The agreement calls for annual payments of \$80,583 over the life of the lease. The effective interest rate on the capital lease is approximately 6.39%. As of September 30, 2007 and 2006, the recorded value on the System's balance sheet is \$344,608 with accumulated amortization of \$172,304 and \$103,382, respectively. Amortization of capital leases is included with depreciation expense for financial statement presentation.

In December 2005, the System entered into a capital lease arrangement for IV equipment. The lease agreement is non-cancelable for 5 years. The agreement calls for annual payments of \$83,160 over the life of the lease. The effective interest rate on the capital lease is approximately 7%. As of September 30, 2007 and 2006, the recorded value on the System's balance sheet is \$349,979 with accumulated amortization of \$43,747 and \$20,412, respectively. Amortization of capital leases is included with depreciation expense for financial statement presentation.

Future payments under all capital lease obligations are as follows:

Year Ending September 30,	
2008	\$ 163,743
2009	163,743
2010	96,590
2011	23,823
	<u>447,899</u>
Less interest	(44,024)
	<u>\$ 403,875</u>

8. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement arrangements with major third-party payors is as follows:

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment System). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The System's classification of patients under the Prospective Payment System and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

Medicaid

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

The System participates in the Disproportionate Share Hospital program. Subject to certain qualification criteria, the System is entitled to participate in the program annually. The System recognized reimbursement from the program within net patient revenue of approximately \$4,800,000 and \$2,500,000 during the years ended September 30, 2007 and 2006, respectively. At September 30, 2007 and 2006, the System has a receivable from the program of approximately \$2,000,000 and \$-0-, respectively. This program is a Federal program administered by the state. There is currently a one year moratorium on a change in the regulation related to the eligibility to participate in the program, which if left unchanged would expire in May 2008. The ultimate outcome and potential impact of the change in the regulation is unknown.

Other Payors

The System also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

A summary of net patient service revenue, contractual adjustments and charity care for the years ended September 30, 2007 and 2006 follows:

	<u>2007</u>	<u>2006</u>
Patient service revenue		
Inpatient		
Routine services	\$ 14,834,517	\$ 14,464,280
Ancillary services	15,539,716	16,918,962
Outpatient		
Ancillary services	57,777,732	53,080,974
Physician services	15,384,273	14,928,266
Charity care	<u>(1,776,955)</u>	<u>(1,199,653)</u>
Patient service revenue	101,759,283	98,192,829
Contractual adjustments	<u>(46,442,398)</u>	<u>(44,946,683)</u>
Net patient service revenue	<u>\$ 55,316,885</u>	<u>\$ 53,246,146</u>

9. CONCENTRATIONS OF CREDIT RISK

The System grants credit without collateral to its patients, most of who are local residents and are generally insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30, 2007 and 2006, is as follows:

	<u>2007</u>	<u>2006</u>
Medicare	36%	39%
Commercial insurance	15%	14%
Patients	22%	23%
Medicaid	17%	17%
Blue Cross	10%	7%
	<u>100%</u>	<u>100%</u>

10. AFFILIATION AGREEMENTS

The System has an affiliation agreement with a health system located in central Indiana to identify areas of collaboration in providing clinical services. No change in control of the System occurred as a result of the agreement. However, neither of the parties is allowed to enter into another affiliation agreement without prior approval of the other party.

FAYETTE REGIONAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS SEPTEMBER 30, 2007 AND 2006

During fiscal year 2006, the System entered into a regional affiliation agreement with a health system and cardiology group located in eastern Indiana to provide cardiology services to the System at the Heart Center. The initial term of this agreement is for the period of two years commencing on September 5, 2006 and terminating on September 4, 2008. No change in the control of the System occurred as a result of the agreement.

11. FUNCTIONAL EXPENSES

The System is an acute care facility providing long-term care and home health services. The System provides inpatient, outpatient and other ancillary services to residents within its geographical location. Expenses related to providing these services approximate the following:

	2007	2006
Health care services	\$ 49,095,823	\$ 49,037,886
Administrative and general	7,346,298	6,953,299
	<u>\$ 56,442,121</u>	<u>\$ 55,991,185</u>

12. COMMITMENTS AND CONTINGENCIES

Self-Funded Health Plan

The System is committed to pay for employees' health care costs. A third-party administrator has been retained to process and present all benefit claims to the System for payment. The System has purchased excess loss insurance from Madison National Life Insurance Company. The System is responsible for the funding of all claims and related administrative costs up to \$100,000 per individual per policy year and up to \$275,370 per month on the group as a whole as of September 30, 2007. Group Health insurance expense for the years ended September 30, 2007 and 2006 totaled \$2,492,938 and \$4,273,531, respectively.

Litigation

The System is involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without adverse effect on the Systems future position or results from operations.